

Nonresident Alien Income and Tax Withheld, 1971-1979

By Chris Carson*

The Internal Revenue Code requires that income paid by U.S. "persons" to nonresident aliens be taxed by withholding. In 1979, over \$5 billion of income was paid to nonresident aliens by U.S. organizations and "persons." The U.S. tax withheld on this income exceeded \$620 million. This tax was applied primarily to "passive" or unearned income, that is, income that was not connected with the conduct of a trade or business in the United States.

The basic tax rate on this income is 30 percent, although certain types of income are taxed at lower rates. Income paid to residents of countries that have entered into tax treaties with the United States, however, is typically taxed at a lower rate, also varying by type of income. The payor of the income is responsible for withholding this tax. When the tax is withheld, this represents final payment of the tax liability. No additional forms need be filed by either the recipient or the payor. Common examples of income subject to this tax are: dividends, interest, certain capital gains, royalties, pensions, scholarships, alimony and compensation for certain services. Certain kinds of most of these forms of income are exempt from withholding [1]. These include interest on deposits, certain dividends, interest on U.S. Treasury bills, and most capital gains. The major payors (organizations and "persons") of this income are corporations, individuals, partnerships, estates, and trusts.

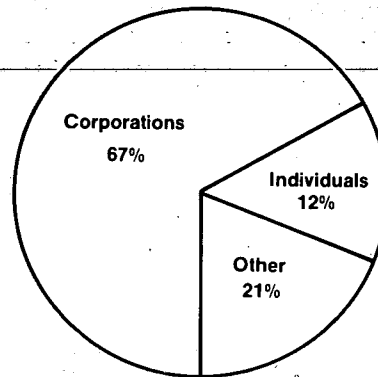
The most common types of income paid to nonresident aliens are dividends and interest. These accounted for approximately 86 percent of all income paid in 1979.

The relatively large percentage of total tax withheld on dividend income can be attributed partially to higher tax rates on dividend income than on most other

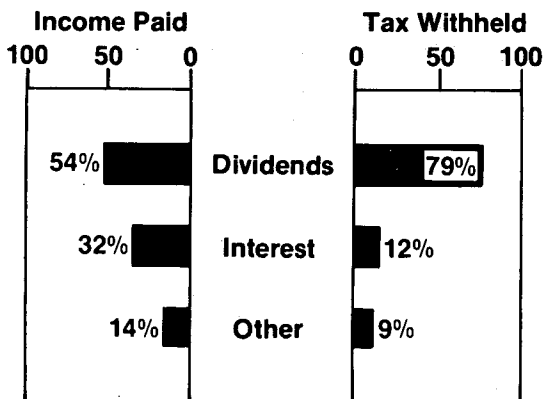
income types in many major income-receiving countries with tax treaties. The tax rate on interest payments to recipients in these countries is usually lower. In the case of most kinds of interest payments to some countries, for example, the United Kingdom and West Germany, no U.S. tax is withheld.

Corporations and individuals received about 79 percent of all U.S. income paid to nonresident alien persons. Other common recipients include: partnerships, fiduciaries, nominees, government organizations, exempt organizations, and private foundations.

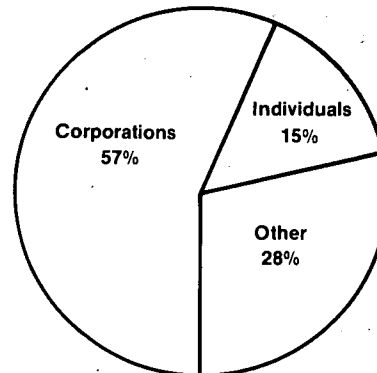
Percent of Total Income Paid, by Recipient Type, 1979



Percent of Total Income Paid and Percent of Total Tax Withheld, by Income Type, 1979



Percent of Total Tax Withheld, by Recipient Type, 1979



*Foreign Statistics Section. Prepared under the direction of Daniel F. Skelly, Chief, with technical assistance from Bill States.

The percent of income that is exempt from withholding varies among recipient types. Only 57 percent of the total U.S. tax withheld was withheld from income paid to foreign corporations, although these same foreign corporations received 67 percent of the total income. This can be attributed to the fact that a relatively large amount of income paid to corporations was exempt from withholding (32 percent). As only 20 percent of the income paid to individuals and 19 percent of the income paid to other noncorporate recipients was exempt from withholding, their proportion of the total tax withheld was relatively high (15 percent and 28 percent, respectively) when compared to the proportion of income they received (12 percent and 21 percent, respectively).

Although recipients in tax treaty countries typically enjoy lower U.S. tax rates, if the income is paid to a nominee or fiduciary, additional withholding is often required to be held by the country of the nominee or fiduciary in accordance with the applicable tax treaty. The purpose of this additional withholding is to prevent citizens of nontreaty countries from taking advantage of the lower tax rates of treaty countries. The foreign government holds this additional tax until the ultimate recipient proves residency in that country. If residence is not proven within a period of time specified by the treaty, the tax is remitted to the United States (see Table 2, column 7.) In the case of Canada, nominees and fiduciaries remit this additional tax directly to the Internal Revenue Service (IRS), acting as the withholding agents.

INCOME AND TAX TRENDS

Both income paid and tax withheld have increased substantially in recent years [2]. Between 1977 and 1979, income has risen 55 percent while taxes rose 33 percent. The fact that income has risen faster than taxes is partially due to a sharp increase in the amount of income exempt from withholding (129 percent) compared to the increase in income subject to withholding (40 percent) during this period.

Trends by Income Type

Interest paid, which increased by 139 percent in this period, was the major factor in the total increase in income. This is probably attributable to the rising interest rates available to investors in the United States during this period. Dividend income and other income types increased by 34 percent and 37 percent, respectively.

<u>Income Type</u>	<u>Gross Income Paid</u> (in thousands)		
	<u>1977</u>	<u>1978</u>	<u>1979</u>
Dividends.....	\$2,047,105	\$2,867,596	\$2,707,108
Interest.....	666,053	990,949	1,591,309
Other.....	525,369	592,262	717,728
Total.....	3,238,527	4,450,807	5,016,145

Trends by Country of Recipient

Increases in the amount of income paid to residents of certain countries have been substantial. From 1971 to 1979, income paid to recipients in West Germany and Japan has increased approximately three-fold and five-fold, respectively, after adjustments for inflation. The yearly real increase, in 1971 dollars, for Japan exceeded 20 percent while such increases for West Germany and France were greater than 10 percent.

BASIC TABLE INFORMATION

Table 1 shows gross income paid by year and percentage change in this income paid for selected countries. Shown for 1979, in Table 2, are number of Forms 1042S (Income Subject to Withholding Under Chapter 3, Internal Revenue Code) filed, income paid, and tax withheld by treaty and nontreaty countries. Other treaty and nontreaty country data are available for tax haven countries in a separate report [3]. Tax amounts withheld by domestic and foreign withholding agents are also shown. Gross income paid is categorized by amounts subject to withholding and amounts exempt from withholding. Shown in Table 3 are total income paid and amounts of tax withheld by income type for corporations and individuals in selected countries for 1979.

Information dealing with the source of the data and the sample can be found following these tables.

Nonresident Alien Income and Tax, 1971-1979

Table 1.--Gross Income Paid by Year, Percent Total Increase, and Percent Increase Per Year, by Country of Recipient

[Money amounts are in thousands of dollars]

Country or Geographic area	Gross income paid			Percent increase--1971 to 1979			
	1971	1975	1979	Total	Average per year	1971 dollars ¹	
						Total	Average per year
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Total.....	1,671,097	2,634,179	5,016,145	200.2	14.7	77.1	7.4
Canada.....	265,815	406,901	780,663	193.6	14.4	73.0	7.1
France.....	75,264	192,806	357,150	374.5	21.5	179.9	13.7
Germany, Federal Republic.....	74,479	95,370	380,628	411.0	22.6	201.7	14.8
Japan.....	40,340	90,466	341,371	746.2	30.6	399.2	22.3
Netherlands.....	193,528	209,842	477,056	146.5	11.9	45.4	4.8
Netherlands Antilles.....	164,028	212,122	343,328	109.3	9.7	23.5	2.7
Switzerland.....	314,141	600,027	702,376	123.5	10.6	31.9	3.5
United Kingdom.....	352,465	410,468	633,676	79.7	7.6	6.0	0.7
Other countries.....	191,037	416,177	999,897	423.4	23.0	208.7	15.1

¹1979 dollars deflated using GNP Implicit Price Deflator [4]. Percentages showing average change per year were computed considering the effects of compounding.

Table 2.--Number of Forms 1042S Filed, Gross Income Paid, Tax Withheld, and Other Items, by Selected Treaty and Nontreaty Countries, 1979

[Money amounts are in thousands of dollars]

Country or Geographic area	Number of Forms 1042S filed	Income paid			Tax withheld		
		Total	Exempt from withholding	Subject to withholding	Total	Domestic withholding agents	Foreign Governments and withholding agents
Total.....	585,905	5,016,145	1,377,483	3,638,662	620,546	545,980	74,566
Treaty country, total.....	484,137	4,266,829	1,233,292	3,033,537	506,557	431,991	74,566
Australia.....	7,247	11,726	1,659	10,067	2,011	2,011	-
Austria.....	4,648	11,815	3,174	8,641	1,721	1,721	-
Belgium.....	12,102	86,410	15,808	70,602	13,583	10,645	2,938
Canada.....	260,444	779,663	178,815	600,848	119,023	119,023	-
France.....	14,175	357,121	29,773	327,348	36,736	36,216	520
Germany, Federal Republic...	45,797	380,628	241,033	139,595	19,619	19,619	-
Italy.....	7,751	37,449	16,628	20,821	4,928	4,928	-
Japan.....	4,799	341,371	95,893	245,478	25,007	25,007	-
Luxembourg.....	6,369	20,662	4,502	16,160	4,409	3,749	660
Netherlands.....	14,360	477,056	75,825	401,231	41,050	40,426	624
Netherlands Antilles.....	1,675	343,328	283,754	59,574	7,820	7,815	5
Sweden.....	4,672	45,899	12,969	32,930	3,318	3,318	-
Switzerland.....	23,366	702,376	78,578	623,798	153,881	85,211	68,670
United Kingdom.....	57,296	614,729	171,487	443,242	67,548	66,411	1,137
Other treaty countries.....	19,436	56,596	23,394	33,202	5,903	5,891	12
Nontreaty country, total.....	101,768	749,316	144,191	605,125	113,989	113,989	-
Bahamas.....	2,114	16,883	131	16,752	4,785	4,785	-
Bermuda.....	1,991	35,336	2,165	33,171	9,750	9,750	-
Cayman Islands.....	548	13,382	9,620	3,762	1,072	1,072	-
Hong Kong.....	8,101	14,003	1,076	12,927	3,664	3,664	-
Liechtenstein.....	788	20,051	712	19,339	3,929	3,929	-
Mexico.....	6,943	25,437	2,526	22,911	6,584	6,584	-
Panama.....	2,013	21,412	4,180	17,232	4,822	4,822	-
Portugal.....	1,269	11,738	130	11,608	1,097	1,097	-
Saudi Arabia.....	1,142	20,771	19,784	987	289	289	-
Spain.....	4,039	10,404	254	10,150	2,738	2,738	-
Other nontreaty countries...	72,820	559,899	103,613	456,286	75,259	75,259	-

Nonresident Alien Income and Tax, 1971-1979

Table 3.--Number of Forms 1042S Filed, Gross Income, and Tax Withheld by Income Type, by Recipient Type and Country of Recipient, 1979

[Money amounts are in thousands of dollars]

Country or Geographic area	Number of Forms 1042S filed	Gross income paid	Tax withheld			
			Total	Interest	Dividends	Other
	(1)	(2)	(3)	(4)	(5)	(6)
ALL RECIPIENTS						
Total.....	585,905	5,016,145	545,980	66,091	429,286	50,603
Australia.....	7,247	11,726	2,011	208	792	1,011
Austria.....	4,648	11,815	1,721	18	1,603	100
Bahamas.....	2,114	16,883	4,785	313	4,055	417
Belgium.....	12,102	86,410	10,645	3,174	6,945	526
Bermuda.....	1,991	35,336	9,750	4,279	3,911	1,560
Canada.....	260,444	779,663	119,023	22,763	88,546	7,714
Cayman Islands.....	548	13,382	1,072	210	800	62
France.....	14,175	357,121	36,216	5,130	27,542	3,544
Germany, Federal Republic.....	45,797	380,628	19,619	274	18,151	1,194
Hong Kong.....	8,101	14,003	3,664	209	3,123	332
Italy.....	7,751	37,449	4,928	1,048	1,266	2,614
Japan.....	4,799	341,371	25,007	10,259	9,120	5,628
Liechtenstein.....	788	20,051	3,929	259	3,458	212
Luxembourg.....	6,369	20,662	3,749	135	3,586	28
Mexico.....	6,943	25,437	6,584	582	2,009	3,993
Netherlands.....	14,360	477,056	40,426	2,203	33,478	4,745
Netherlands Antilles.....	1,675	343,328	7,815	2,034	5,482	299
Panama.....	2,013	21,412	4,822	427	3,557	838
Portugal.....	1,269	11,738	1,097	56	1,023	18
Saudi Arabia.....	1,142	20,771	289	11	265	13
Spain.....	4,039	10,404	2,738	821	1,173	744
Sweden.....	4,672	45,899	3,318	95	2,335	888
Switzerland.....	23,366	702,376	85,211	6,593	76,607	2,011
United Kingdom.....	57,296	614,729	66,411	539	59,559	6,313
Other countries.....	92,256	616,495	81,150	4,451	70,900	5,799
INDIVIDUALS						
Total.....	407,819	577,480	81,589	6,626	53,738	21,225
Australia.....	6,154	5,692	796	114	401	281
Austria.....	2,149	6,052	1,183	11	1,073	99
Bahamas.....	800	2,744	796	50	419	327
Belgium.....	7,175	9,176	1,394	39	1,077	278
Bermuda.....	653	4,856	1,430	46	857	527
Canada.....	196,689	114,850	12,405	1,816	8,093	2,496
Cayman Islands.....	94	301	87	25	61	1
France.....	10,107	39,920	4,769	430	2,861	1,478
Germany, Federal Republic.....	36,723	44,243	4,242	98	3,321	823
Hong Kong.....	5,858	6,950	1,947	59	1,761	127
Italy.....	6,388	16,947	3,497	243	689	2,565
Japan.....	3,570	20,919	2,078	512	1,148	418
Liechtenstein.....	362	11,397	1,614	43	1,467	104
Luxembourg.....	1,213	1,568	335	1	328	6
Mexico.....	5,847	10,029	2,631	373	1,372	886
Netherlands.....	4,817	17,098	1,750	17	1,198	535
Netherlands Antilles.....	460	17,988	446	2	397	47
Panama.....	1,260	2,984	745	16	684	45
Portugal.....	996	9,867	558	23	517	18
Saudi Arabia.....	998	1,440	247	9	226	12
Spain.....	3,388	6,339	1,549	133	827	589
Sweden.....	4,101	6,335	1,047	34	243	770
Switzerland.....	9,333	50,737	8,216	567	6,394	1,255
United Kingdom.....	28,229	59,250	7,554	153	3,892	3,509
Other countries.....	70,455	109,798	20,273	1,812	14,432	4,029
CORPORATIONS						
Total.....	101,204	3,357,263	309,333	53,737	234,250	21,346
Australia.....	571	4,913	1,035	80	287	668
Austria.....	852	4,149	339	1	337	1
Bahamas.....	856	10,253	2,872	191	2,622	59
Belgium.....	3,383	56,165	6,159	2,692	3,222	245
Bermuda.....	838	26,615	7,267	4,095	2,236	936
Canada.....	39,809	531,104	52,965	19,343	28,862	4,760
Cayman Islands.....	355	12,578	847	166	629	52
France.....	1,401	218,713	18,552	3,762	13,000	1,790
Germany, Federal Republic.....	2,902	169,177	8,103	91	7,685	327
Hong Kong.....	455	4,244	1,049	121	729	199
Italy.....	292	12,569	566	421	140	5
Japan.....	964	311,247	21,957	9,528	7,367	5,062
Liechtenstein.....	197	5,199	1,415	126	1,183	106
Luxembourg.....	4,880	14,197	2,429	38	2,368	23
Mexico.....	388	8,017	1,843	155	339	1,349
Netherlands.....	7,402	317,880	28,199	2,184	25,732	283
Netherlands Antilles.....	952	304,514	5,696	1,899	3,561	236
Panama.....	503	13,622	3,269	334	2,143	792
Portugal.....	89	1,733	500	24	476	-
Saudi Arabia.....	18	60	18	2	16	-
Spain.....	145	2,871	858	665	98	95
Sweden.....	134	34,804	1,751	61	1,688	2
Switzerland.....	5,891	487,979	54,481	5,340	48,435	706
United Kingdom.....	17,387	441,422	44,130	361	41,325	2,444
Other countries.....	10,540	363,238	43,033	2,057	39,770	1,206

DATA SOURCES AND LIMITATIONS

Payors of income to nonresident aliens are required to withhold tax in accordance with Chapter 3 of the Internal Revenue Code. The Form 1042, U.S. Annual Return of Income Tax To Be Paid at Source (Under Chapter 3, Internal Revenue Code), and Form 1042S, Income Subject to Withholding Under Chapter 3, Internal Revenue Code, must be filed to report these payments and the associated U.S. tax withheld on this income. These forms are filed by the payor of the income or a "person" (usually a financial institution) acting on behalf of the payor. The Form 1042S is an information return that is filed for each income recipient. The information reported on the Form 1042S includes type of income, type of recipient, gross income paid, tax rate, amount of tax withheld, the country of legal residence of the recipient and the identity of the recipient. These forms are filed with the Form 1042 which identifies the tax liability of the payor. Filing is required even if no withholding tax is due, as in the case of income effectively connected with a trade or business in the United States.

These statistics are tabulated by calendar year, based on all Forms 1042S, processed at the Philadelphia Service Center. However, dividend, interest, and other totals for 1977 were imputed as only 99 percent of all Forms 1042S had been processed when those tabulations were made. The total income figure for that year represents 100 percent of the forms filed. The years indicated in the tables represent the year the income was paid and the U.S. tax withheld, except the tax from foreign governments and foreign withholding agents. These amounts are shown by the year this tax was remitted to the United States under treaty agreements. Canadian nominees and fiduciaries remit this additional tax directly to the IRS. These amounts are represented in the tables as though the tax were withheld by a U.S. withholding agent.

Tax withheld amounts and percentages shown in text figures and Table 3 do not include tax withheld by foreign governments and withholding agents (except Canada). This additional withholding cannot be properly attributed to specific recipient and income types. Correct 1979 income paid and tax withheld amounts could not be determined for Venezuela. Therefore, these amounts were estimated based on data for prior years. These data are included as part of the "Total" and "Other Countries" categories. Venezuela is not a tax treaty country.

As all forms 1042S are included in these statistics, they are not subject to sampling error. The data are subject to nonsampling errors such as computer data entry errors and taxpayer reporting errors. Forms 1042S with gross income greater than \$500,000 were manually verified. A limited computerized correction program was used to test the data for basic numerical relationships.

Definitions

Nonresident Alien.--An individual whose residence is not within the United States and who is not a U.S. citizen. Corporations, private foundations and partnerships created or organized outside the United States are also considered nonresident aliens.

Withholding Agent.--Any person (individual, corporation, partnership, estate, or trust) required to withhold tax. Usually the withholding agent is the payor of the income or a "person" (usually a financial institution) acting on behalf of the payor. A foreign nominee or fiduciary required to withhold additional tax under a tax treaty is also a withholding agent.

Income Effectively Connected With A Trade or Business.--Income that is effectively connected with the conduct of a trade or business in the United States is exempt from withholding. This income is subject to the same tax rates that apply to U.S. citizens, residents, and corporations.

Nominee.--An entity, chosen or appointed to accept income for, or act on behalf of, the eventual recipient of the income. Typically, a financial institution acts as nominee.

Other Income.--Income reported on a Form 1042S that is other than dividends and interest is defined for purposes of this article as "other income." Included in this category are such items as royalties, pensions, scholarships, alimony, certain capital gains, and compensation for certain services.

References

- [1] Department of the Treasury, Internal Revenue Service, Publication 515, Withholding of Tax on Non-resident Aliens and Foreign Corporations, (Revised November 1980).
- [2] Department of the Treasury, Internal Revenue Service, Annual Report - Commissioner of Internal Revenue, annual data through 1978.
- [3] Department of the Treasury, Internal Revenue Service, Tax Haven Study Group, Estimates of Levels of Tax Haven Use, May 1981 (unpublished report).
- [4] U.S. Department of Commerce, Bureau of Economic Analysis, Survey of Current Business, September 1981, Vol. 61, No. 9, p. 16. Also U.S. Department of Commerce, Bureau of Economic Analysis, The National Income and Product Accounts of the United States, 1929-76 Statistical Tables, September 1981, p. 319.